

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

CLAREMONT PROPERTIES, INC., A
California Corporation,

Debtor.

Case No. 92-58498-MM

Chapter 11

MEMORANDUM OPINION

INTRODUCTION

Before the Court for consideration is the confirmation of the debtor's chapter 11 plan of reorganization. For the reasons set forth below, the Court will reopen the evidence to allow the debtor to establish whether its plan is feasible as required by 11 U.S.C. § 1129(a)(11) and whether it is fair and equitable under § 1129(b)(1).

FACTS

The debtor, Claremont Properties, Inc., owns a 1.16-acre parcel of real estate located in San Mateo, California. The Pedersen Family Trust, which sold the property to the debtor, holds a first deed of trust on the property to secure a \$1.7 million note by the debtor. There are six additional junior deeds of trust or liens totalling \$4,145,000.

The debtor filed its chapter 11 petition on December 8, 1992. The premise of the debtor's proposed plan and reorganization efforts is the construction and operation of a senior housing center on the property. Toward that end, the debtor and Hensel Phelps Construction Corporation have

1 jointly formed SMRC, Inc., an independent corporation, to implement the plan. The proposed plan
2 provides that the debtor will convey the property to SMRC in return for a \$1 million note and 45% of
3 SMRC's issued stock.

4 SMRC has obtained a commitment letter from SIAM Holdings S.A. for the construction and
5 permanent financing of the senior housing center. The commitment letter provides for financing in
6 the amount of \$28,950,000 for the construction and leasing of the senior facility. In addition,
7 Claremont Properties has already acquired the necessary entitlements and has completed the
8 application process to obtain the permit necessary to commence construction. The debtor,
9 through SMRC, has engaged Hensel Phelps to perform the construction for \$20,400,000. It is
10 anticipated that the balance of the funds committed for financing, or \$8,550,000, will be sufficient to
11 pay in full Pedersen's first deed of trust, additional construction expenses, architectural and
12 engineering expenses, management and leasing expenses, mortgage brokers' fees, all of the debtor's
13 chapter 11 administrative expenses and post-petition loans, other site improvements, and to make the
14 payments on the debtor's other secured obligations during the period that the units have not been
15 leased.

16 The proposed plan provides that junior secured creditors will be subordinated to the
17 \$20,400,000 construction loan and issued new notes in the amounts of their respective secured
18 claims. The notes will bear interest at 7%, will be amortized over 20 years, are not payable until two
19 years after the completion of construction, and thereafter balloon in eight years. SMRC will pay the
20 debtor's chapter 11 administrative expenses and secured debt service. Unsecured creditors will share
21 pro rata in the proceeds of the debtor's \$1 million note and SMRC stock.

22 The confirmation hearing was held on October 1, 1993. In support of feasibility, the debtor
23 introduced testimony by Ken Abler, the principal of the debtor, that the debtor's income and expense
24 projections submitted in support of its disclosure statement are consistent with the projections in two
25 feasibility studies commissioned by the debtor and its predecessor. The debtor did not introduce any
26 documentary evidence at the time of the confirmation hearing. John Haesley, who holds a judgment
27 lien against the property to secure a debt for \$150,000 and is experienced in consulting and
28 development in the real estate industry, testified that the property is not suitable for residential

1 purposes and is valued at no more than \$2 million.

2
3 **ISSUES**

4 The only issues are whether the plan proposed by the debtor is feasible under § 1129(a)(11)¹
5 and whether it is fair and equitable under § 1129(b)².

6
7 **DISCUSSION**

8 At the close of the confirmation hearing, the Court required the parties to submit post-hearing
9 briefs on the allocation of the burden of proof on feasibility of a chapter 11 plan and whether that
10 burden had been satisfied. The debtor and Haesley filed briefs after the confirmation hearing. The
11 debtor also filed with the court the following documents: 1) a January 1990 appraisal of a proposed
12 retirement community conducted by Valuation Counselors, Inc.; 2) a June 1993 appraisal of a
13 proposed retirement community conducted by Real Estate Advisory Group; and 3) a copy of the
14 commitment letter from SIAM Holdings. Both appraisals are based on a January 1990 market study
15 by Laventhol & Horwath. The documents submitted subsequent to the confirmation hearing have not
16 been admitted into evidence.

17
18 **A. Burden of Proof**

19 The plan proponent, or the debtor in this case, bears the burden of proof on feasibility. In re
20 Consul Reastaurant Corp., 146 Bankr. 979, 984 (Bankr. D. Minn. 1992); In re Woodstock, 120
21 Bankr. 436, 453 (Bankr. N.D. Ill. 1990). The debtor must establish the feasibility of its plan by a
22 preponderance of the evidence. Consul Restaurant, 146 Bankr. at 984. Accord Grogan v. Garner,

23
24 _____
25 ¹11 U.S.C. § 1129(a)(11) sets forth the requirement for confirmation that:
Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the
debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

26 ²11 U.S.C. § 1129(b)(1) provides in pertinent part:
27 [T]he court . . . shall confirm the plan notwithstanding the requirements of [§ 1129(a)(8)] if the plan does not discriminate
28 unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted,
the plan.

111 S. Ct. 654, 659 (1991) (preponderance of the evidence standard is presumed to apply in civil actions between private litigants unless particularly important individual interests or rights are at stake). Claremont Properties has the burden of proving by a preponderance of the evidence that the proposed plan is feasible and offers a reasonable prospect of success.

B. Feasibility

In evaluating the feasibility of a plan of reorganization, the Court must assess whether the provisions of the plan that are to be accomplished after confirmation can be done as a practical matter under the facts. In re Clarkson, 767 F.2d 417, 420 (8th Cir. 1985). The factors relevant to this determination include the earning power of the business, the adequacy of its capital structure, economic conditions, continuation of present management, the efficiency of management in control of the business after confirmation, and any other related matter which determines the prospects of a sufficiently successful operation to enable performance of the provisions of the plan. In re U.S. Truck Co., Inc., 800 F.2d 581, 589 (6th Cir. 1986); In re Mulberry Phosphates, Inc., 149 Bankr. 702, 709 (Bankr. M.D. Fla. 1993). The Court must review the totality of circumstances to determine whether the plan meets the feasibility requirement for confirmation. Mulberry Phosphates, 149 Bankr. at 709.

Proof of the feasibility of a plan is evidentiary in nature. In re Keaton, 88 Bankr. 154, 157 (Bankr. S.D. Ohio 1988). The debtor must provide factual support for its income and expense projections. In re Hobbie-Diamond Cattle Co., 89 Bankr. 856, 858 (Bankr. D. Mont. 1988). Speculative, conjectural, or unrealistic predictions cannot be used to predict financial progress. Id. As further discussed below, the debtor in this case has provided no factual support, let alone speculative and conjectural support, for its projections or its ability to fund the plan.

C. Sufficiency of Projections

Where the debtor intends to retire an obligation over an extended period of time under a plan of reorganization, the debtor is required to satisfy a stricter standard of proof of the plan's feasibility. In re Agawam Creative Marketing Associates, Inc., 63 Bankr. 612, 619 (Bankr. D. Mass. 1986); In re White, 36 Bankr. 199, 204 (Bankr. D. Kan. 1983). Under the plan, each junior secured creditor

1 will receive a new note payable commencing two years from the completion of construction and that
2 balloons eight years after the first note payment. The treatment proposed in the plan requires each
3 secured creditor to defer payment of interest, as well as principal, for an extended and an indefinite
4 period. Although Claremont Properties is required to satisfy a stricter standard of proof of the
5 proposed plan's feasibility, it has failed to do so.

6 The debtor did not introduce any expert testimony or additional evidence other than the
7 interested testimony of its principal, Ken Abler, in support of its financial projections. Mr. Abler
8 failed to explain to the court how the projections were derived or what the underlying assumptions
9 are. Without additional evidence of the debtor's projected income and expenditures, the Court cannot
10 make a practical evaluation of the probability of the debtor's actual performance of the plan's terms.
11 In re Heron, Burchette, Ruckert & Rothwell, 148 Bankr. 660, 684 (Bankr. D.D.C. 1992)(the court
12 must evaluate the probability of actual performance of the provisions of the plan to determine
13 whether the plan meets feasibility requirement).

14 The feasibility requirement for confirmation of a proposed plan of reorganization requires the
15 court to determine independently whether the plan is workable and has a reasonable likelihood of
16 success. In re Drexel Burnham Lambert Group, Inc., 138 Bankr. 723, 762 (Bankr. S.D.N.Y. 1992).
17 Based on the evidence that has been admitted, the Court cannot make such a determination. See
18 Keaton, 88 Bankr. at 157-58 (where the plan proponent fails to present evidence regarding the
19 debtor's financial condition, the court is prevented from determining whether the plan is feasible).

20 21 **D. Debtor's Ability to Fund Plan**

22 If outside financing is needed, it must be clearly in sight. In re Marsh Co., Inc., 12 Bankr.
23 401, 403 (Bankr. D. Mass. 1981). The debtor introduced testimony by Ken Abler that he
24 investigated the lender's ability to fund the plan per the loan commitment. Martin Fleisher, counsel
25 for SMRC, also testified that he attempted to verify the legitimacy of SIAM Holdings' loan
26 commitment to SMRC. Both also testified as to SIAM Holdings' other investments, conversations
27 with SIAM Holdings' representatives, and their personal opinions of SIAM Holdings' ability or
28 willingness to fund the loan. However, at the time of the hearing, an executed copy of the

commitment letter had not been furnished to the court. The debtor has not introduced the proposed loan documents or any additional evidence regarding SIAM Holdings' overall financial strength or diversity of investment portfolio, so the court has insufficient evidence to assess the legitimacy of the loan commitment. Based on the evidence that is presently before the court, the court is unable to make a determination regarding the likelihood that financing will occur. On that basis, the Court is not in a position to rule on the feasibility of the debtor's plan. In re Stratford Associates, Ltd., 145 Bankr. 689, 699 (Bankr. D. Kan. 1992)(generally, the court cannot determine that a plan is feasible without proper funding in place or a firm commitment of funding).

E. Fairness of a Negative Amortization Plan

Although the parties have not addressed the issue, the Court may confirm a plan under § 1129(b)(1) over an objection if the plan does not discriminate unfairly and is fair and equitable. The debtor's proposed plan provides for negative amortization with respect to its treatment of junior secured creditors. Negative amortization refers to the deferral and accrual of part or all of the interest on a secured claim; the accrued interest is added to the principal and paid when the debtor's income is higher. In re Sierra Woods Group, 953 F.2d 1174, 1176 (9th Cir. 1992). Although a negative amortization plan is not per se unconfirmable, such a plan must provide the secured creditor with the present value of its allowed claim. Because such plans are "fraught with pitfalls that unfairly endanger creditors," confirmation requires the debtor to satisfy a stringent standard for fairness. Id. at 1177. Whether a negative amortization plan is fair and equitable is determined on a case by case basis.³ The debtor has introduced no evidence as to whether the proposed plan is fair and equitable.

³A non-exclusive list of the factors that are relevant to the determination whether a negative amortization plan is fair includes:

1. Does the plan offer a market rate of interest and present value of the deferred payments;
2. Is the amount and length of the proposed deferral reasonable;
3. Is the ratio of debt to value satisfactory throughout the plan;
4. Are the debtor's financial projections reasonable and sufficiently proven, or is the plan feasible;
5. What is the nature of the collateral, and is the value of the collateral appreciating, depreciating, or stable;
6. Are the risks unduly shifted to the creditor;
7. Are the risks borne by one secured creditor or class of secured creditors;
8. Does the plan preclude the secured creditor's foreclosure;
9. Did the original loan terms provide for negative amortization; and
10. Are there adequate safeguards to protect the secured creditor against plan failure.

CONCLUSION

Based on the evidence that is presently before the court, the court is unable to make a determination whether the debtor has satisfied either the feasibility requirement or the requirement that the plan be fair and equitable. Claremont Properties has not met its burden of proof. The evidence on plan confirmation shall be reopened at a continued hearing to allow the debtor the opportunity to present additional evidence in support of confirmation, specifically, evidence regarding: 1) the sufficiency of the debtor's income and expense projections; 2) the debtor's ability to fund the plan from the SIAM Holdings loan commitment; and 3) whether the plan, which provides for negative amortization, is fair and equitable. Counsel for the parties shall contact the Court's courtroom deputy, Mildred Williams, to schedule an evidentiary hearing.

In re Sierra Woods, 953 F.2d at 1178.